HYMANS ROBERTSON

2024 Outlook for charity DB pension funding

August 2024

Summary

The last few years have been challenging for charities. The rising cost of living has resulted in new calls for support in many areas, as well as continued strains on fundraising. However, our analysis paints a much rosier picture for charities with DB schemes this year. Charity income (across the top 40 charities we consider) is on the rise, and has now exceeded pre-Covid levels.

At the same time, many DB pension schemes sponsored by charities have seen significant improvement in their funding levels – benefiting from the recent rises in gilts yields and their relatively low levels of hedging in their asset strategies. This has resulted in pension scheme liabilities falling by more than the assets and increasing the funding level. For many charities, this means the option of securing the pension scheme liabilities with an insurer and removing the risk from the balance sheet is now within closer reach than ever before.

The increase in charity income, to above pre-Covid levels, means charities may also be in a position to increase contributions or access some additional funding to help reach buy-out. Charities should be considering acting to lock in these funding level gains and starting to plan for buy-out.

Generally, we expect run-on to be less appealing for most charity schemes, given both average scheme size and appetite from a charity to continuing to run on their scheme. However, any charities considering this as a viable option should also be considering how to manage the funding of their scheme and reduce risk of future funding deficits.

We've analysed the DB pension exposures of the largest 40 charities in England & Wales (by income) over the last 6 years. We consider how charity income and reserves have changed as well as movements in the pension scheme deficit and asset strategy.

These charities now have a combined **£50bn** of reserves.

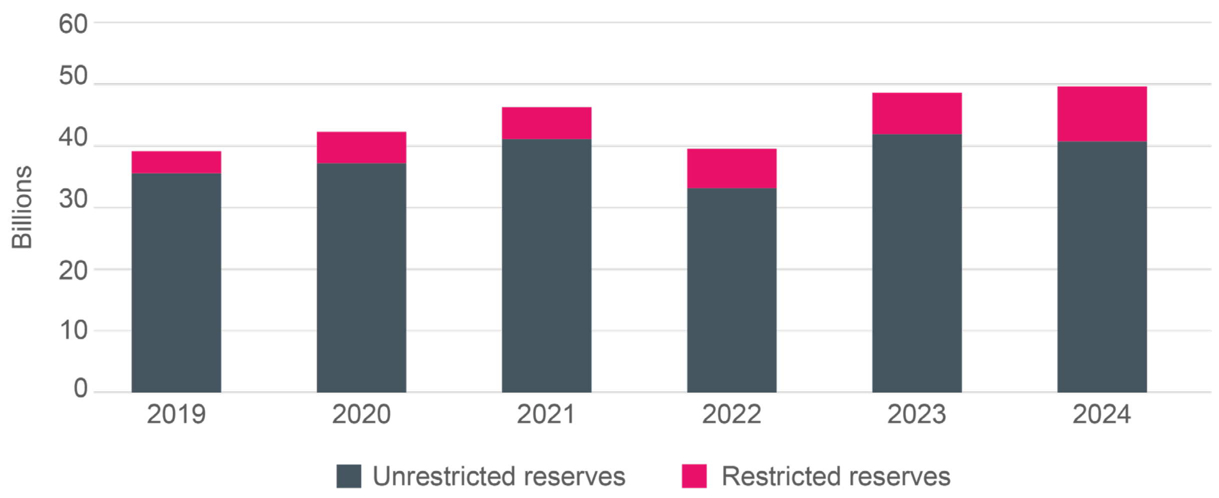
This has increased from **£39bn** since 2019.

Aggregate DB liabilities are around **£7bn** which is a decrease from **£9bn** in 2019.

We have also seen a rise in funding level from **81%** in 2019 to **99%** in 2024.

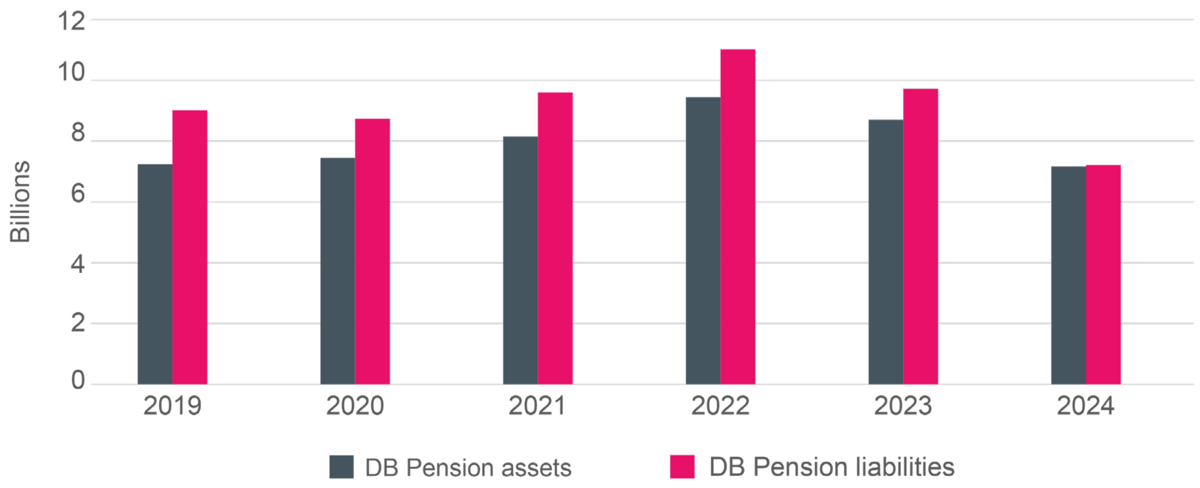
This year's aggregate charity income is **£15bn**, which has increased from **£12.6bn** in 2019.

Progression in charity reserves over time, split between restricted and unrestricted reserves



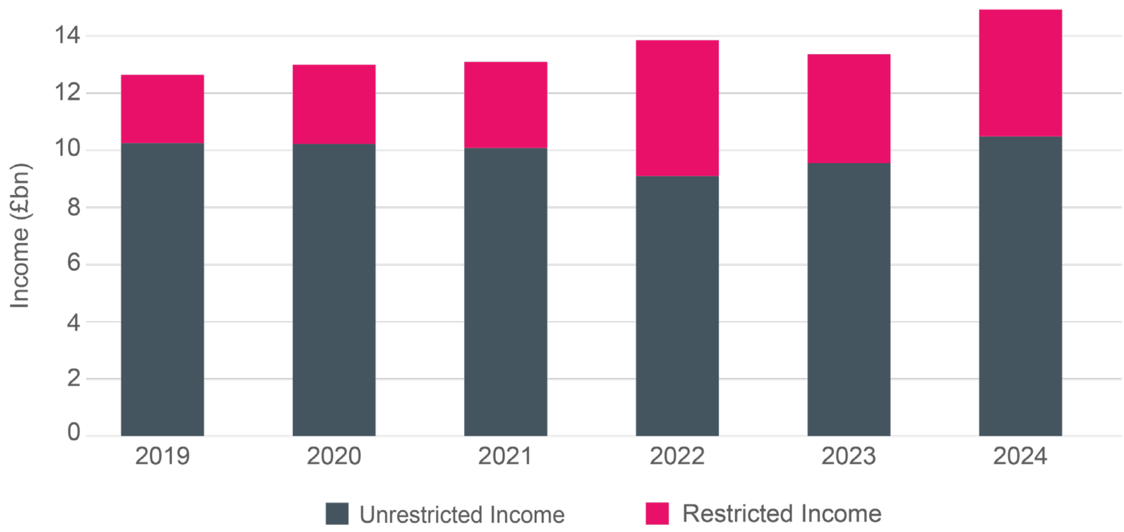
Restricted reserves are now approaching £10bn with unrestricted reserves down slightly to £40bn. Aggregate total reserves are now c£50bn.

Progression in aggregate DB pension scheme assets and liabilities over time



Both assets and liabilities of the DB pension schemes have dropped to around £7bn, with a larger drop on the liability side. Liabilities are measured on the charities' accounting basis. This has resulted in an improvement in funding levels to close to 100%. This is a significant turnaround in funding over the last few years with a 20% increase since 2019. This will have brought buy-out closer for many with a 20% improvement in funding potentially halving the expected time to buy-out.

Progression in charity income split between restricted and unrestricted income

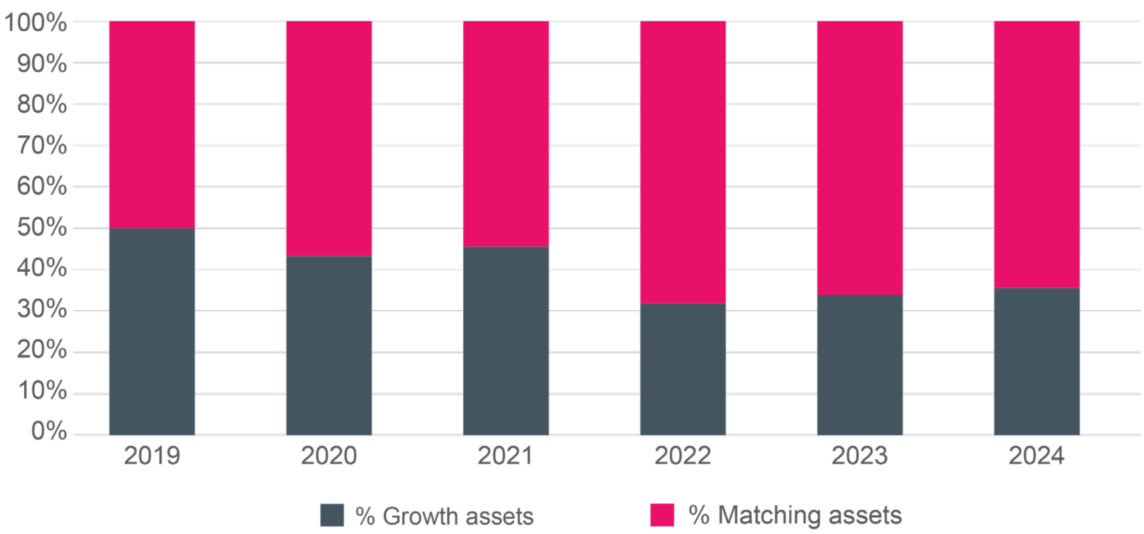


Underlying income from fundraising and charitable activities (grey) has now exceeded the pre Covid levels of around £10bn with total charity income hitting an all-time high of £15bn (over the last 6 years).

Combined, these metrics paint a much-improved picture for pension schemes sponsored by charities – improved funding levels alongside increased reserves and income levels may mean buy-out is closer than anticipated for many charity DB schemes. On the flip side, the general rosier position all round could mean some charities may now be considering run-on of their schemes a more appealing option.

Of course, the aggregate figures do hide some more challenging situations for some charities where contributions to fund the DB scheme may still be a struggle and placing strains on charity finances. For these schemes continuing to focus on sustainable funding of the scheme will be key.

Progression in split between growth and matching assets over time



Charity DB Schemes have (on average) retained more growth assets in their investment strategy than the "average" UK DB scheme. This, (along with a lower level of interest rate matching assets), has contributed to the increase in average funding level over the last few years. Since 2019, the allocation to growth assets has fallen from around 50% to 30% as schemes funding levels improve and hedging levels are increased. Charity schemes should be considering if the risk in their asset strategies remains appropriate and consider how to manage this in the run up to buy-out.

What should be on your pension scheme meeting agenda?

Consider risk transfer options – remember the member

With a dynamic risk transfer market and new provider solutions, planning for a scheme's endgame is complex. Charities should ensure they understand all the possible endgame options including buy-out, run-on and consolidators. We generally expect most charities will still consider buy-out to be the right option, but they must consider factors like scheme size and stakeholder beliefs.

Ultimately, the charity and the trustees of the DB scheme must take care to "remember the member" – keeping member's interests front of mind when planning for buy-out and considering that security of benefits, communications and understanding is vital.

2023 was a record year for risk transfer transactions, characterised by a shift towards full-scheme buy-ins, many multi-billion-pound buy-ins and a sustained change in market dynamics as insurers felt the resourcing pinch driven by high demand. However, demand did not affect pricing, which remained competitive.

Demand continues to grow in 2024. If trustees want insurers to give their pension scheme a high priority, they need an appropriate broking process. They also need their governance, investment, data and benefits to be transaction ready. Charities should ensure they understand their timeline to buy-out and start to put plans in place to be ready to transact when the time is right. Smaller charity schemes need to act carefully to ensure that they approach the market in the best way to get maximum engagement and hence the best pricing from insurers.

DB Funding Code of Practice

While buy-out and endgame planning may be front of mind, charities and DB scheme trustees also need to continue to consider and comply with the DB Funding Code of Practice. We await some final details on the code, which is due to come into force in Autumn 2024. Charities should stay informed on this detail.

In the new code, covenant gets much more attention than it did previously. The regulations explicitly require, for the first time, that trustees consider employer covenant. Trustees of the DB scheme will need to give more consideration to factors affecting the charity's future capacity to support the scheme, including forming a view on how long the covenant is 'reasonably certain'. This may be a challenge for some charities to reach a conclusion on. We are expecting further guidance from TPR on covenant, but this is not likely to cover the nuances when considering covenant for a charity, rather than a company.

Approach projects with efficiency and value in mind

Many DB Schemes have significant project work to tackle in the next few years, including GMP equalisation, data and benefit reviews, and implementation of pensions dashboards.

Charities should ensure that their pension scheme trustees have a good handle on these costs and are challenging their advisers to bring them value for money and efficiency in tackling these projects.

In the lead up to buy-out, charities and their DB scheme trustees should have a clear project plan that is both realistic and tackles these projects in the correct order, to minimise time and cost. Good governance and project oversight will ensure charities are streamlining these costs.

Analysis – further information

The ability of a charity to support its DB obligations is more important than the size of the liabilities or deficit in isolation. Our analysis, therefore, focuses on the size of the pension scheme relative to the size of the charity. The pension deficit in these measures is the FRS102 deficit, as reported in charity accounts.

We measured the top 40 charities by income, only including those that sponsor a DB scheme. Therefore, the charities that are included in our analysis may change on an annual basis.

All data is taken from annual charity accounts and therefore may be applicable at different dates, depending on the accounting year end.

Charity
Nuffield Health
The Charities Aid Foundation
The British Council
The Arts Council of England
Cancer Research UK
The National Trust for Places of Historic Interest or Natural Beauty
Cardiff University
United Learning LTD
Wellcome Trust
Benefact Trust Limited
The British Red Cross Society
Oxfam
British Heart Foundation
Swansea University
The Ormiston Trust
Barnardo's
Royal Commonwealth Society for the Blind
The Shaw Trust Limited
The Save the Children Fund
The Girls' Day School Trust

Charity
Change, Grow, Live
The Salvation Army
Methodist Homes
The Salvation Army Social Work Trust
Oasis Charitable Trust
Motability
The Royal National Lifeboat Institution
Macmillan Cancer Support
Canal & River Trust
University of South Wales/Prifysgol de Cymru
AQA Education
Royal Mencap Society
The Francis Crick Institute
St Andrew's Healthcare
Genome Research Limited
The Eric Wright Charitable Trust
Canterbury Christ Church University
University of Wales: Trinity Saint David
Trustees of the London Clinic Limited
The National Association of Citizens Advice Bureaux

Please get in touch with us to find out more:

Heather Allingham
Head of DB Pensions Consulting for Charities
heather.allingham@hymans.co.uk
0141 566 7779

Matthew Dickson
Actuarial Trainee Consultant
matthew.dickson@hymans.co.uk
0131 656 5057

London | Birmingham | Glasgow | Edinburgh

T 020 7082 6000 | www.hymans.co.uk